In the Supreme Court of the United States

OCTOBER TERM, 1952

No. 566

CARTER H. HARRISON, INDIVIDUALLY AND AS COLLECTOR OF INTERNAL REVENUE, PETITIONER

v.

EDWIN J. BOHNEN, EXECUTOR OF THE ESTATE OF MARY A. BOHNEN, AND INDIVIDUALLY; THEODORE B. BOHNEN AND VIRGINIA BOHNEN

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

REPLY BRIEF FOR THE PETITIONER

An analysis of the taxpayers' arguments makes it apparent, despite repeated protestations to the contrary, that this Court is being asked to repudiate the rationale of *Helvering* v. *LeGierse*, 312 U. S. 531, and its companion cases.

To support their ultimate contention that the decedent did not make a transfer with a retained life income that is taxable under Code Section 811 (c) (1) (B), the taxpayers start with an unstated assumption, either that the two contracts

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were always completely separate or else that, by assigning the life policy to her children, the decedent effectuated a severance of her single investment with the insurance company. (Br. 16, 18.) There were, it is argued, two separate contracts with the insurance company—the life policy, to which full ownership, including the right to any income, had been transferred to the children (Br. 20–21, 39, 41), and an annuity contract, under which the payments to the decedent were true annuity payments, consisting partially of income and partially of returns of capital (Br. 7, 20–23, 39–45, 46). These two contracts, in the taxpayers' view, are so completely unrelated that, if the decedent dies prematurely, the unpaid principal (which the taxpayers conceive as remaining under the separate annuity contract) redounds, not to the benefit of the holders of the life policy, but to the exclusive benefit of the insurance company. (Br. 42–43.) The extra sum which the insurance company must pay to the holders of the life policy (which the taxpayers, at another point (Br. 41) recognize to be equal to the alleged unused corpus of the annuity fund) is, then, supposed to come from some other, unrelated source.

1. Since these assumptions are flatly contradicted by this Court's holding in *LeGierse,* it seems appropriate to analyze that case in the light of the taxpayers' explanation of the similar transaction here involved.

The reason the life policy in *LeGierse* was held not to be true "insurance" under the predecessor of Code Section 811 (g) is that there was no group sharing of the risk of premature death (p. 540), since the company, by requiring the purchase of the non-refundable annuity contract, always possessed a fund (consisting of the two premiums) more than sufficient to pay the face amount of the life policy no matter when death occurred (pp. 541–542). The excess of the fund over the face amount of the life policy financed loading and other similar charges. Several important conclusions must be drawn from *LeGierse*, each of which is contrary to the taxpayers' basic assumptions. Together, they demonstrate the invalidity of the taxpayers' ultimate contention.

(a) No "insurance" was involved in *LeGierse* because what was paid at death originated, not with insurance reserves contributed by other policy holders, but with the combined premiums originally furnished by the decedent. While it was recognized (p. 537) that the premiums were calculated separately, and that the company maintained separate reserves for each type of contract so that, on the company's books, it would appear that the death payment came out of ordinary life insurance reserves, *LeGierse* looked through these forms to decide that the substance of the matter was altogether different. No matter what the bookkeeping entries of the company, there was

never any true insurance risk, since the net effect of the transaction was the same as an investment of a single fund equal (exclusive of loading factor) to what was to be paid at death.

The taxpayers, quite clearly, are wrong in assuming that the two contracts are to be considered, within the purview of the estate tax, as having the separate characteristics common to annuities and life insurance policies. For example, the assumption (Resp. Br. 42–43) that, on death, the unexhausted premium paid for the annuity contract would not be paid to the holders of the life policy, "but would remain the property of the insurance company" is true only in the most technical sense, and in this technical sense only by regarding the "annuity policy" as a true annuity contract. Actually, since the annuitant's death requires the company to pay the face amount of the life policy and since *LeGierse* refused to accept the proposition that the normal insurance reserves bore the risk of this payment, the source out of which the death payment is made must be the combined premiums paid by the decedent.

A corollary of the taxpayers' view of what happens to the annuity payment on death is their view of the nature of the payments to the decedent during life. As we have already noted, they consider that the payments are true annuity payments, consisting partially of income and partially of returns of capital. In other words, the

taxing statute is supposed to view the company as possessing two funds—one of which is being consumed during the decedent's life in the form of annuity payments, and the other of which the company holds separately, with the income being accumulated and added to corpus for payment to the owners of the life policy. (Resp. Br. 20–23.) This artificial concept of two funds, separately held, with one being diminished by payments out of capital and the other being augmented by accumulations of income exactly equal to the amount of capital paid out of the annuity fund is, we submit, also contrary to the reasoning of *LeGierse* which looked to the total consideration paid in the form of two premiums and which refused to separate them to create distinct annuity and insurance reserves. As is fully developed in our opening brief, it is more consonant with the realities of the situation to consider, just as would be true if there had been a single contract and a single premium, that the entire net premium paid under both contracts is held intact by the company to satisfy the death payment and that what is paid during the decedent's lifetime represents an agreed rate of return on that fund. It follows that the decedent retained the only income that was earned by the investment made in the form of separate premium payments. The various mathematical computations employed by the taxpayer (Br. 22–23, 42) establish nothing whatsoever since they are based on the fallacious

assumption that separate funds were involved, one having the characteristic of a true annuity fund and the other the characteristic of a true insurance reserve.

(b) When *LeGierse* ruled (pp. 540–541) that these contracts "must be considered together" and that, so considered, they present no insurance risk, the opinion was doing more than merely reiterating the admitted fact that the company required the annuity contract to be purchased as a condition for issuing the life policy without a medical examination. It was describing a continuing relationship between the related contracts and funds supplied by the decedent—a relationship which, of necessity, continued at least until the company had satisfied its obligation under the life policy. The continued existence of this unity is, quite clearly, essential to the holding that the proceeds of the life policy came, in effect, from the decedent's investment and not from the reserves supplied by other policy holders. And, since the true source which enables the company to make a payment on the death of an uninsurable person would obviously not be affected by an assignment of the policy, observed (p. 541) that the two contracts would continue to counteract each other "no matter who held the policy and the annuity."

The taxpayers, as is apparent from the preceding analysis, proceed from the premise that the fund held by the company became fragmented

and that the character of the payments which it was to make became altered by the mere fact that the decedent had assigned the life policy. It is sufficient to observe that the taxpayers point to nothing which would establish the validity of this proposition or which would at all detract from the explicit contrary statement in *LeGierse,* quoted above.

2. The examples given by the taxpayer (Br. 16–18) in an attempt to detract from our position, actually demonstrate how the taxpayers misconceive the issue presented by this case. The taxpayers liken the situation here to one where a person desires to buy a particular item of property to be given to a son, but cannot acquire that particular item without also buying another item. He buys both, gives one to his son and retains the other. We agree that no estate tax would be due on the property given away, even though the donor was originally required to acquire a combination of properties.

That, of course, has nothing to do with this case. The combination of contracts here, unlike the examples given, was required, not to satisfy some whim of the insurance company, *but because the contracts turn on the decedent's death.* The $72,000 payment the decedent's children received at her death was received because of her death and because the decedent, during her lifetime, transferred a sufficient fund to enable the company to make the payment at her death.

Code Section 811 (c) (1) (B) is applicable, not because this was a simple combination of contracts, but because it was a combination which terminated at death, which enabled the children to receive this sum at death, and which permitted the decedent to receive the earnings on the fund during her lifetime.

In this regard, it should be noted that the taxpayers also misconceive the issue when they state that the decedent (Br. 7–8) "could have accomplished her purpose just as well by simply buying the annuity policy, and making a gift of cash to the transferees in the amount of the premium allocated to the life policy." First, the decedent's purpose was to give her children $72,000 at her death—not the $53,000 premium allocated to that policy, and the children actually received the former amount, not the latter. The decedent could not have accomplished this objective except by taking out the combination of policies. Second, in every case where there is a reservation of a life estate with a vested remainder in others, the decedent could have made an *inter-vivos* transfer to the donee of an amount equal to the present value of the remainder. It is, of course, no answer to the applicability of Section 811 (c) (1) (B) that the decedent could have made a different, nontaxable transfer.

3. The taxpayers make much of the point that the children could have taken down the cash

surrender value of the life policy at any time (Br. 27–29) and that the payment to the decedent would have continued during the balance of her life (Br. 20). In our opening brief (pp. 18–22), we demonstrated why it is that the events which existed at the decedent's death are determinative and why it is unnecessary to consider what the taxable situation would have been if the children had been content to take a lesser sum prior to death. Further, it should be observed that if the unity of the contracts had actually been severed by payment of the cash surrender value of the life policy (an unlikely circumstance where the life of an uninsurable person is involved), so that the company would have assumed the risk of an ordinary annuity—that the annuitant would outlive life expectancy—the character of its payments would necessarily have become altered since it no longer would possess a hedging contract. But this does not establish at all that, in the absence of severance, the character of the payments should be determined by what they would have been had there been a severance.

CONCLUSION

The decision of the Court of Appeals is erroneous and should be reversed.

Respectfully submitted.

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APRIL 1953.

U. S. GOVERNMENT PRINTING OFFICE: 1953